

E 00605

P. 26 BLANK

(b) (1) (2) (3)

R/Emidon Bant p. 28.

Iraq: Debt Problems Persist [REDACTED]

Higher oil revenues have improved Iraq's debt servicing record and increased its access to new credits, but Baghdad continues to reschedule most of its debt. We believe Iraq's \$40 billion debt will continue to grow during the next several years as Baghdad seeks financing for reconstruction and civilian and military imports and treats most debt repayment as a low priority. Iraq will not reduce its debt until oil revenues rise significantly, probably not before the mid-1990s. Baghdad's creditors are likely to tolerate Iraq's debt servicing problems during the near term. Continued poor debt management, however, would probably cause lenders to further restrict already limited credit lines to Iraq, forcing cuts in civilian spending and risking greater popular dissatisfaction with President Saddam Husayn's regime. [REDACTED]

From Riches to Rags

Baghdad's extensive use of foreign loans since 1982 has transformed Iraq from one of the Third World's richest countries to one of its largest debtors. The accumulation of debt stems from Baghdad's decision to continue pursuing an ambitious economic development program despite the outbreak of war with Iran in 1980. Civilian spending remained high while military expenditures increased and oil exports fell sharply because of Iranian-inflicted damage to oil facilities. [REDACTED]

In response to the worsening financial picture, in 1983 Baghdad adopted domestic austerity measures and began borrowing from trading partners and its Persian Gulf Arab allies. Iraq's foreign debt rose from \$5.6 billion—mostly short-term trade credits—before the war to roughly \$40 billion at yearend 1988. In addition, Iraq's Gulf allies, principally Saudi Arabia and Kuwait, provided about \$36 billion in financial assistance—oil sold on Baghdad's behalf and cash transfers—during the period 1980-88. [REDACTED]

[REDACTED] We doubt Baghdad will repay this debt regardless of whether or not the Saudis and Kuwaits formally cancel it. [REDACTED]

Iraq's inability to meet its financial obligations to creditors during the war led it to reschedule most of its debt, including short-term trade credits and interest payments. Large debt payments due combined with low world oil prices precipitated a financial crisis in Iraq in 1986. Baghdad signed bilateral rescheduling accords with most of its creditors and ignored most other requests for payment. Iraq's poor payment record caused governments that had not already cut off credit lines to do so, forcing Iraq to scramble to pay for essential imports. [REDACTED]

More Payments Bring More Credits

Higher oil revenues allowed Iraq to improve its debt servicing record somewhat in 1987-88. Oil earnings of roughly \$11.5 billion last year were about 60-percent higher than in 1986 when Baghdad's financial woes reached a crisis point. Iraq has been making larger and more timely debt payments compared with two years ago, according to diplomatic and press reporting. Even so, Iraq is paying most of its creditors only a portion of what they are owed—frequently just interest—and continues to reschedule most of its debt. Last year Iraq rescheduled \$1.5-2 billion in debt due during the period 1987-89 and is seeking to reschedule several billion dollars more. [REDACTED]

P. 28 BLANK



Baghdad will probably continue to elicit concessions from most of its creditors, at least during the near term. Many lenders view Iraq's large oil reserves as a guarantee of its eventual ability to pay off its debt—a view that Iraqi officials encourage. Many suppliers are eager to gain a foothold in the potentially lucrative Iraqi market and to participate in postwar reconstruction and development projects. Suppliers want to resolve debt disputes and are encouraging their governments to guarantee new credits to Baghdad, especially in light of the recent announcements that the United Kingdom and the United States will provide large credit facilities to Iraq in 1989. This competitive environment will continue to limit creditors' willingness and ability to force Iraq to negotiate debt agreements on a multilateral instead of bilateral basis. Furthermore, creditors probably realize that if they refuse to reschedule Iraqi debt they risk not getting paid at all.

Longer Term Risks

Creditors' current guarded optimism could change, however, if Baghdad fails to further improve its debt servicing record now that the war with Iran is over. Iraq elicited concessions from many creditors during

the war by promising them preferential treatment and higher payments after the conflict ended. Some lenders are likely to lose patience if Baghdad fails to deliver on these promises. Iraq faces large debt service payments in the early 1990s when much of its debt rescheduled during the past few years comes due. Continued failure to service its short-term debt, in particular, could cause governments and banks to cut off short-term credits, precipitating a financial crisis similar to the one in 1986. Baghdad would be forced to curtail civilian imports and development spending, slowing economic recovery. Such cutbacks would be likely to increase popular dissatisfaction with Saddam Husayn's regime, particularly because Iraq's war-weary population has high expectations for economic improvement. [redacted]

Over the longer term, we believe Iraq is in a better position than most Third World countries to improve its debtor status. Its vast oil wealth—Iraq possesses the second largest oil reserves in the world—provides Baghdad with a reliable source of income. Furthermore, Saddam Husayn's pride and aversion to foreign dependence will probably motivate him to eventually try to pay off the debt. [redacted]